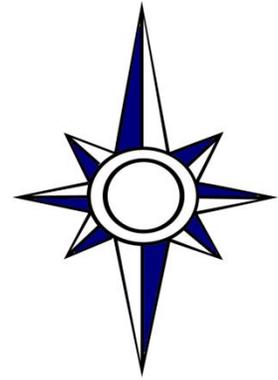


Comparative Connections

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China-Taiwan Relations: Slow, Steady Improvements

David G. Brown
Johns Hopkins School of Advanced International Studies

This has been a quiet but constructive quarter in cross-Strait relations. Taipei and Beijing were focused on ratifying and beginning implementation of the Economic Cooperation Framework Agreement (ECFA). With Beijing's agreement, Singapore and Taipei announced that they would consider negotiating a WTO-consistent economic cooperation agreement. This important flexibility by Beijing allows President Ma to show that ECFA has opened the door at least slightly to Taiwan's involvement in regional trade liberalization. Despite Washington's approval of small commercial arms sales, Beijing indicated a willingness to resume military exchanges with Washington. Nevertheless, arms sales to Taiwan remain a threat to US-China relations.

ECFA

After signing the ECFA in June, both sides prepared for its implementation, with more potential drama on the Taiwan side. In July and August, Taipei's Legislative Yuan (LY) held two special sessions to consider the agreement. Although the opposition Democratic Progressive Party (DPP) has resorted to heavy-handed tactics to block consideration of other legislation, it chose in this instance to compromise and accept that the ruling Kuomintang (KMT) had the votes to pass the agreement. As polling indicated that ECFA had majority support among the public, the DPP concluded that there was nothing to be gained by attempting to block passage. At the second special session in mid-August, the LY first approved the ECFA and then passed the amendments to the Customs Import Tariff Act needed to implement the agreement. Afterward, DPP Chairperson Tsai Ing-wen said that when the DPP returned to government, the people would be given an opportunity to decide about ECFA.

On Sept. 10, the two sides exchanged the notifications needed to bring ECFA into effect. Over the next two years, the "early harvest" tariff reductions will be implemented. In addition, the two sides are discussing the modalities under which they will establish the Cross-Strait Economic Cooperation Committee charged with carrying out the consultations and negotiations envisaged in the agreement. The ECFA instructs the committee to launch a very ambitious array of negotiations within the next six months. Each side will be represented on the committee by a team of officials, reportedly to be led by a vice minister. This joint committee will be the most senior and important forum for regular contact between officials from the two sides. As ECFA is technically an agreement between the two authorized quasi-official associations – Beijing's Association for Relations Across the Taiwan Straits (ARATS) and Taipei's Straits Exchange Foundation (SEF) – neither side will assert that the committee is an official body. This approach has been crucial to the development of regular direct contacts between officials of the two sides over the past two years.

In the coming months, both sides will also be preparing for the sixth meeting between ARATS President Chen Yunlin and SEF Chairman Chiang Pin-kung in December. Chiang has said that Taipei's goal is to sign investment protection and medical cooperation agreements at that time.

An FTA-like agreement

President Ma Ying-jeou had said in promoting ECFA's benefits that it would open the door for Taiwan to sign agreements resembling free trade agreements (FTAs) with its trade partners and break through the isolation from regional trade liberalization that is harming Taiwan. There was much speculation in Taipei and an equal amount of silence in Beijing about whether this would happen. On Aug. 5, trade officials in Singapore and Taipei announced that the two would start exploratory talks on entering into a "WTO-consistent economic cooperation agreement." That same day the Foreign Ministry in Beijing reiterated Beijing's "consistent" position expressing the hope that relevant countries would abide by the "one-China principle." Beijing's Taiwan Affairs Office (TAO) urged Taiwan to uphold the two sides' common foundation for cross-strait relations. The Presidential Office in Taipei thanked Beijing for not blocking this initiative.

How this well-choreographed launch was arranged remains unclear, but it is unlikely that either Singapore or Taipei would have taken this step without a prior understanding with Beijing. The key was to treat the endeavor strictly as a trade issue with no broader implications. It is also noteworthy that Taipei has not rushed to launch similar talks with other ASEAN trade partners, despite the Presidential Office's statement that it would pursue other agreements. When a Philippine trade official said Manila looked forward to a similar agreement by yearend, Taipei did not move to take up the offer. Taipei appears to have decided wisely to move slowly on this front so as not to arouse suspicions in Beijing. One other thing appears clear – Beijing does not believe the Singapore-Taipei talks should set a precedent for similar talks between Taipei and its major developed country trade partners.

PRC students and degrees

It was nearly a year ago that Education Minister Wu Chung-chi announced plans for Taiwan universities to begin accepting students from China in undergraduate and graduate degree programs, noting that implementing legislation would be needed. For much of the past year, the DPP has been delaying or blocking consideration of the legislation, at times provoking physical confrontations in the LY. To accommodate a variety of opposition and societal concerns, the administration's plans incorporated a variety of restrictions, including for example: a low ceiling of 2,000 for the number of People's Republic of China (PRC) students in Taiwan, a requirement that PRC students not be given any break on tuition, and that the students should be banned from taking jobs in Taiwan.

Finally, in August, the special LY session took up and passed three amendments that would open the door to PRC degree students and also begin recognizing certain degrees earned by Taiwan students at certain PRC universities. After reaching compromises with the KMT, under which some of the restrictions would be put into the legislation rather than implemented by regulations,

the DPP decided not to further obstruct passage of the legislation. Because of the delays, PRC undergraduate students will have to wait until next fall to enroll in Taiwan universities.

In any event, after a long delay, opening the door to PRC degree students, a step of potential long-term importance to easing cross-Strait tensions, will start next year. How many PRC students will participate under the existing restrictions remains to be seen. While the opposition was delaying Taiwan's opening, Beijing in April eased the admission process for Taiwan students seeking admission to Chinese universities.

Cultural exchange

In July 2009, the KMT and Chinese Communist Party (CCP) conducted a forum on culture. For Beijing, that was a first step on a new issue highlighted in the third of Hu Jintao's Six Points which aims to "promote the exquisite traditions of Chinese culture ... so as to boost our (meaning cross-Strait) national consciousness." In September this year, PRC Minister of Culture Cai Wu led a large delegation to Taipei, where he participated in a forum on cultural cooperation with his counterpart, Emile Sheng, minister of the Council on Cultural Affairs. Minister Cai called for negotiation of a cultural agreement to complement ECFA. Taipei's participants called for governments to remove a variety of restrictions and regulations that hamper joint cultural activities by the private sector.

Security issues

Reports issued in August by the Department of Defense (DOD) in Washington and the Ministry of National Defense (MND) in Taipei both noted that the build-up of Chinese missiles threatening Taiwan continues despite the improvements in cross-Strait relations. What may be a first glimmer of light on this issue came in reports of remarks Premier Wen Jiabao made to the overseas Chinese press in New York on Sept. 23. He was quoted as saying that the missiles would eventually be removed. Unfortunately, *Xinhua* did not carry his remarks so there is no authoritative report on what Premier Wen said. Nevertheless, his comment was welcomed in Taipei, where Premier Wu Den-yih said it was a sign of goodwill. DPP Chairperson Tsai Ing-wen described Wen's remark as vague and meaningless. In Washington, the White House welcomed Wen's statement as an example of pragmatism.

In mid-August, Washington quietly approved three direct commercial sales (DCS) for US firms to supply Taiwan with hardware and services to upgrade radars for the Indigenous Defense Fighter and the Po-sheng programs. Beijing's public response was limited to a pro forma statement by the Foreign Ministry spokesman. Although Beijing had earlier threatened sanctions against companies involved in arms sales, no such action has been taken. Three weeks later, when US National Security Council (NSC) Deputy Advisor Thomas Donilon visited Beijing, President Hu Jintao indicated Beijing was open to resuming military-to-military contacts, which had been suspended after the announcement of a \$6.4 billion package of arms sales to Taiwan in January. Defense Secretary Robert Gates, who was not invited in June, now has an invitation and may visit in early October.

Elsewhere, there are signs of continuing Chinese efforts to constrain US arms sales. In January, Beijing had asserted that the arms package was a clear violation of the 1982 US-China Joint Communiqué on arms sales – an argument that was seldom heard over the past decade. Reportedly, the Chinese tried to engage the US in a formal review of the 1982 Communiqué at the US-China Security and Economic Dialogue meeting in May, but the US did not agree. There has also been mention in Beijing of a Chinese initiative by former State Councilor Tang Jiaxuan to launch a track II process with Henry Kissinger on the arms sales issue. Why is Beijing now, after some years, again pressing the US to abide by the 1982 communiqué? Perhaps because it believes its increased power and influence will elicit a different response from the US than it did in the 1990s. However, few Chinese accept that there was a deal in the 1982 communiqué – that, on the premise that China's policy toward Taiwan was peaceful, the US would reduce arms sales. However, since the 1996 Taiwan Strait missile crisis, Beijing's declared policy of peaceful reunification has been buttressed by an increasing powerful military component.

Meanwhile, Washington is assessing Taiwan's air defense needs. A classified DOD report mandated by Congress is reportedly nearing completion. The work on that report will inform the administration's consideration of two large pending requirements: upgrading Taiwan's current fleet of *F-16 A/B* aircraft and the sale of 66 new *F-16 C/D* aircraft. Given the unclassified assessment in the published DOD report to Congress on the PLA that the balance of forces continues to shift in the PRC's favor, the classified report is likely to make a strong military case for Taiwan's need to improve its air defenses. The upgrade program should be less controversial, and hence easier for Washington to act on, but finding an opportune time for an announcement when Washington is planning for a visit by Hu Jintao in January and other high level US-China events later in 2011 will not be easy.

Following the conclusion of the ECFA, there has been speculation about moving the cross-Strait dialogue toward political issues. However, President Ma and other officials have continued to caution that attention must remain focused on economic and cultural issues. In late July, the PRC Defense Ministry spokesman said that discussions on military mutual trust measures – the PRC term for military CBMs – could begin. While MND welcomed this, the Mainland Affairs Council (MAC) in Taipei reiterated that economics would remain the main focus. In late September, Premier Wu reiterated to the LY that the time is not ripe to discuss CBMs.

Despite this caution, a cross-Strait maritime search and rescue (SAR) exercise was held in the waters between Xiamen and Kinmen in September. This exercise, which involved participation by national-level Coast Guard ships and personnel from both sides, followed an earlier exercise in the same area by local Xiamen and Kinmen SAR assets. This initiative was possible because emergency SAR operations in the area have been handled on a pragmatic humanitarian basis for some time. In addition, the Beijing media downplayed the Coast Guard involvement by describing the exercise as between the two sides' SAR associations and by noting that it was held under the umbrella of the ARATS-SEF maritime agreement, rather than describing it as a military trust-building step.

Diaoyu/Senkaku dispute

Taipei generally avoided involvement in the controversy between China and Japan over the Senkaku Islands. Taipei blocked activists from Hong Kong and Macau from using Taiwanese

fishing boats to stage a protest in the islets but allowed one Taiwanese boat to do so. Taipei's Foreign Ministry reiterated Taiwan's claim to the Diaoyutai more than once, but made clear that it was acting unilaterally and not in cooperation with China.

Other economic issues

Since July 1, 2009 PRC firms have been able to invest in a broad array of sectors in Taiwan. Chinese investment has predictably developed slowly. Taipei's Investment Commission (IC) has reported that total Chinese investment reached only \$80.47 million in the first year ending this June 30. However, the pace of investment has been increasing in recent months. Two months later, the IC reported that cumulative Chinese investment had reached \$144 million by the end of August 2010. In contrast, the IC reported that Taiwan investments in China for January-August 2010 were \$7.4 billion.

However, Taipei has disapproved one major investment. In August, the IC turned down the sale of AIG's Nanshan Insurance Co. to Primus Financial Holdings of Hong Kong. The decision cited the frequent changes in the shareholders of Primus and its Hong Kong partners as the primary reason for the denial. In fact, the concern was that much of the funding came from mainland sources at a time when PRC investors were barred from investing in the insurance sector. This major deal has subsequently been cancelled.

In July, the Hong Kong branches of the Bank of China (BOC) and the Bank of Taiwan (BOT) initiated a foreign exchange settlement arrangement that provides for direct settlement of *Renmenbi* balances, cutting out foreign banks that had previously handled the settlements as middlemen. In September, acting under the recently completed Banking MOU, Beijing authorized four Taiwan banks to open branches on the mainland and Taipei authorized the first two mainland banks to open representative offices in Taiwan. Also in September, Yangzijiang Shipbuilding became the first mainland firm to list its stock on the Taiwan stock exchange.

Looking ahead

In the coming months, Taipei and Beijing will work to establish the Cross-Strait Economic Cooperation Committee and launch the various negotiations the committee is tasked to start within six months. It is likely this process will be drawn out, just as the process of negotiating ECFA was. There was speculation that an announcement on forming the committee might be made when Chiang Pin-kung led a delegation to China in September and met Chen Yunlin, but there was no announcement indicating some procedural issues remain to be resolved. The two sides also will be preparing for the sixth round of SEF-ARATS talks in Taiwan in December.

On Taiwan, attention is focused on the five mayoral elections to be held on Nov. 27. Although cross-Strait issues are not a major factor in these elections, observers in Beijing and elsewhere will be watching the outcome closely because the results will influence the way President Ma will approach cross-Strait issues in the 15 months before he faces re-election in March 2012.

Chronology of China-Taiwan Relations

July - September 2010

July 1, 2010: President Ma Ying-jeou establishes a post- Economic Cooperation Framework Agreement (ECFA) task force on investment climate.

July 5, 2010: Delegation from Guangxi leaves Taiwan after signing \$2.2 billion in deals.

July 7, 2010: Mainland Affairs Council (MAC) poll shows 61 percent support for ECFA.

July 8, 2010: First special Legislative Yuan (LY) Session convenes on ECFA.

July 12, 2010: Hu Jintao receives Kuomintang (KMT) Honorary Chairman Wu Poh-hsiung.

July 26, 2010: Bank of China (BOC) and Bank of Taiwan (BOT) branches in Hong Kong sign new cross-Strait *Renmenbi* settlement agreement.

July 26, 2010: New Second Artillery Corps base is established in Shaoguan, Guangdong.

July 30, 2010: People's Republic of China (PRC) Defense Ministry spokesman Geng Yansheng says discussions on military mutual trust can begin.

July 30, 2010: Taipei Ministry of National Defense (MND) welcomes Geng's statement; MAC reiterates that economics is still main focus.

Aug. 1, 2010: Association for Relations Across the Taiwan Straits (ARATS) Vice Chairman Zhang Mingqing arrives in Taipei for 9-day visit.

Aug. 3, 2010: Taipei's Ministry of Economic Affairs (MOEA) hosts investment seminar in Beijing.

Aug. 3, 2010: Large Hunan provincial delegation ends visit to Taiwan.

Aug. 5, 2010: Singapore and Taipei announce talks to explore possibility of a World Trade Organization (WTO)-based economic cooperation agreement.

Aug. 5, 2010: Beijing's Taiwan Affairs Office (TAO) calls on Taiwan to uphold the common foundation for cross-Strait relations; Ministry of Foreign Affairs calls on countries to abide by one-China principle.

Aug. 5, 2010: Presidential Office in Taipei welcomes Beijing's decision not to obstruct Taiwan signing economic cooperation agreements.

Aug. 6, 2010: Cross-Strait civil air talks reach agreement on additional cross-Strait flights.

Aug. 11, 2010: Referendum Review Committee again rejects Taiwan Solidarity Union's (TSU) ECFA referendum proposal.

Aug. 16, 2010: US Department of Defense (DoD) releases report on military and security developments in People's Republic of China.

Aug. 16, 2010: Guangdong Governor Huang Huahua leads large delegation to Taiwan.

Aug. 17, 2010: Second LY special session ratifies ECFA.

Aug. 18, 2009: LY passes amendments to Customs Import Tariff Act needed to implement ECFA.

Aug. 18, 2010: DPP Chair Tsai Ing-wen says when the DPP regains power, people will decide the fate of the ECFA.

Aug. 18, 2010: Straits Exchange Foundation (SEF) Chairman Chiang Pin-kung says his goal is to conclude investment protection and medical cooperation agreements by year end.

Aug. 22, 2010: TAO Deputy Chair Zheng Lizhong begins low-key visit to Taiwan.

Aug. 24, 2010: US State Department confirms it has notified three commercial arms sales related to Taiwan's air defense and Indigenous Defense Fighter (IDF) radar systems.

Aug. 25, 2010: China and Taiwan stage large joint anti-fraud raid.

Aug. 27, 2010: Beijing MFA calls on US to revoke recent commercial arms sales.

Aug. 30, 2010: Taiwan and Hong Kong's quasi-official trade promotion associations hold first joint meeting in Taipei.

Aug. 31, 2010: Taipei disapproves sale of Nanshan Insurance to a Hong Kong consortium that includes Chinese funding.

Aug. 31, 2010: Taipei releases MND's annual report on PRC military.

Sept. 1, 2010: Philippine Deputy Trade Secretary Adrian Cristobel expects trade pact with Taipei within one year.

Sept. 2, 2010: PRC Culture Minister Cai Wu leads large delegation to Taiwan.

Sept. 2, 2010: Taiwan Ministry of Foreign Affairs launches public campaign for meaningful participation in International Civil Aviation Organization (ICAO) and United Nations Framework Convention on Climate Change (UNFCCC).

Sept. 6, 2010: White House officials Lawrence Summers and Thomas Donilon visit Beijing.

Sept. 6, 2010: Cross-Strait forum on culture held in Taipei.

Sept. 8, 2010: Yangzijiang Shipbuilding becomes first Chinese company to list Taiwan depository receipts (TDRs) on Taiwan Stock Exchange.

Sept. 9, 2010: Jia Qinglin meets Lien Chan in Shanghai, talks of building a consensus for dealing with difficult issues in the future.

Sept. 10, 2010: Jia Qinglin attends Taiwan Compatriot Association Forum and speaks of deepening exchanges.

Sept. 12, 2010: ECFA and intellectual property rights agreements come into effect.

Sept. 13, 2010: Beijing announces approval for joint cross-Strait undersea cables.

Sept. 13, 2010: Large Shanxi province delegation arrives in Taiwan.

Sept. 15, 2010: Beijing approves applications for four Taiwan banks to open branches.

Sept. 16, 2010: Chinese and Taiwan Coast Guard units conduct search and rescue drill.

Sept. 18, 2010: ARATS President Chen Yunlin meets SEF Chair Chiang Pin-kung in Kunshan, but no agreements announced.

Sept. 18, 2010: Vice Minister of Public Security Chen Zhimin concludes visit to Taiwan.

Sept. 22, 2010: Premier Wen Jiabao tells Chinese media in New York that missiles targeting Taiwan will eventually be removed.

Sept. 23, 2010: Taipei approves Bell Operating Company (BOC) and Bank of Communications (BoCom) applications for first PRC banks to open representative offices in Taiwan.

Sept. 24, 2010: Premier Wu Den-yih welcomes Premier Wen's statement on removal of missiles.

Sept. 25, 2010: Commerce Vice Minister Chen Jian leads delegation to Taiwan.

Sept. 28, 2010: Premier Wu reiterates that the time is not ripe for political talks or confidence-building measures (CBMs).

Sept. 29, 2010: US DoD announces resumption of US-China military-to-military exchanges.